INDEX

	Page
Opinions below	1
Jurisdiction	2
Questions presented	2
Statute and rule involved	2
Statement	2
1. The facts relevant to petitioners	3
2. The decision of the district court as to petitioners	6
3. The decision of the court of appeals as to petitioners	7
Argument	8
Conclusion	14

CITATIONS

Cases:

First Trust & Savings Bank v. *Fidelity-Philadelphia Trust Co.*, 214 F. 2d 320	11, 12
Jordan v. *De George*, 341 U.S. 223	13
McGowan v. *Maryland*, 366 U.S. 420	13
Myzel v. *Fields*, 386 F. 2d 718 certiorari denied, 390 U.S. 951	8
Rogen v. *Ilikon Corp.*, 361 F. 2d 260	8
Securities and Exchange Commission v. *Capital Gains Bureau*, 375 U.S. 180	13
Securities and Exchange Commission v. *Chenery Corp.*, 332 U.S. 194	13
Securities and Exchange Commission v. *Texas Gulf Sulphur Co.*, 401 F. 2d 833, certiorari denied *sub nom. Kline* v. *Securities and Exchange Commission*, No. 937, this Term, *Coates* v. *Securities and Exchange Commission*, No. 897, this Term	8
Sproles v. *Binford*, 286 U.S. 374	13
United States v. *Benjamin*, 328 F. 2d 854, certiorari denied, *sub nom. Howard* v. *United States*, 377 U.S. 953	13
United States v. *National Dairy Products Corp.*, 372 U.S. 29	13

350-211—69——1

Constitution, statute and rule:
United States Constitution, Fifth Amendment 13
Securities Exchange Act of 1934:
Section 10(b), 15 U.S.C. 78j(b) 2, 3, 6, 7
Rule 10b–5, 17 CFR 240.10b–5 ..... 2, 3, 6, 7, 8, 9, 11, 13
Miscellaneous:
Conference on Codification of the Federal Securities Laws (remarks of Judge Friendly), 22 Bus. Lawyer 793 (1967) 13
1 Harper and James, *Torts* (1956) 8
Prosser, *Torts* (2d ed. 1955) 8
Restatement, *Torts* § 538(2)(a) (1938) 8
Restatement, *Torts* (Tent. Draft No. 12, April 27, 1966) 7

In the Supreme Court of the United States

OCTOBER TERM, 1968

No. 1185

FREDERICK J. PAGNANI, PETITIONER

v.

SECURITIES AND EXCHANGE COMMISSION

No. 1186

JEROME MATUSOW, PETITIONER

v.

SECURITIES AND EXCHANGE COMMISSION

ON PETITIONS FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. B1–B65)[1] is reported at 407 F. 2d 453. The opinion of the district court (Pet. App. B66–B88) is reported at 259 F. Supp. 99.

[1] References to appendices are to those annexed to the *Pagnani* petition, No. 1185.

JURISDICTION

The judgment of the court of appeals was entered on December 23, 1968. The petitions for writs of certiorari were filed on March 21, 1969. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Whether the court of appeals correctly held that the willingness of a seller of mining property to pay four-sixths of the proceeds of the sale to an individual who could "find" a buyer was a "material" fact with respect to the value of the property.

2. Whether the court of appeals correctly held that petitioners' failure to disclose, in response to questioning by an officer of a corporation issuing shares in exchange for mining property, that petitioner Matusow would receive four-sixths of such shares as a "finder's" fee from the owner of the property, violated Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b–5 thereunder.

STATUTE AND RULE INVOLVED

Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), and Rule 10b–5 promulgated thereunder, 17 C.F.R. 240.10b–5, are set out in Appendix A to the petition in No. 1185.

STATEMENT

This action arises out of three transactions in which Great American Industries, Inc. ("Great American") acquired or proposed to acquire, through the issuance of its securities, three mining properties, located in Arizona, California and Nevada. The only transaction relevant to these petitioners involves the Arizona

property. The Commission's complaint charged that petitioners violated Section 10(b) of the Securities Exchange Act of 1934 ("the Act") and Rule 10b–5 thereunder in failing to disclose to Great American that the owner of a mining property in Arizona was paying to petitioner Matusow as a finder's fee two-thirds of the 200,000 shares of its stock being issued by Great American in exchange for that property (R. 6). On November 7, 1966, the district court denied the Commission's motion preliminarily to enjoin petitioners from further violation of those provisions in connection with the purchase or sale of Great American securities (R. 1502–1504). On December 23, 1968, the court of appeals, sitting *en banc*, reversed the order of the district court as to petitioners and directed the issuance of an "appropriate injunction" (Pet. App. B19).[2]

1. THE FACTS RELEVANT TO PETITIONERS

In March 1966, petitioners entered into a written agreement with William Thomas Beard, who owned all of the outstanding stock of Basin Mining Co., Inc. ("Basin"), which owned a copper property located in Arizona. Under this agreement, Beard transferred four-sixths of his interest in Basin to Matusow and one-sixth to Pagnani. In exchange, Matusow and Pag-

[2] The court of appeals also reversed the order of the district court and directed the issuance of an appropriate injunction as to five other defendants. Four of those defendants have also filed a petition for a writ of certiorari. *Great American Industries, Inc., et al.* v. *Securities and Exchange Commission*, No. 1195, this Term. The Commission is also opposing that petition.

nani promised to "undertake to help promote various mining properties with the view towards a possible sale to private and/or public companies * * *" (R. 1449–1450, 1403).[3]

Also in March, Matusow negotiated with Walter Mack, Chairman of the board of Great American (R. 1228), an option agreement for the purchase by Great American of the Arizona property (R. 1403, 1444). Mack, who had previously been told by Beard that Beard was the owner of the property (R. 1227), entered into the agreement on behalf of Great American. The agreement provided that Beard was to receive $50,000 as consideration for granting an option to the corporation to purchase the property for 200,000 shares of its stock (R. 1451–1452, 1382, 1406). On the date that Beard signed the agreement, March 23, 1966, the five-sixth interest in the 200,000 Great American shares which Beard was to give to petitioners was worth approximately $1,356,875, and the one-sixth interest in the shares which Beard was to retain was worth approximately $268,125 (R. 1641).[4]

On April 4, 1966, the executive committee of the board of directors of Great American authorized the purchase of the Arizona property from Beard pur-

---

[3] In addition, they promised to "endeavor to obtain management contracts for Basin Mining Co., Inc.," and agreed "to utilize their best efforts in this connection, to promote the company and to assist it in performing its various mining functions such as developing and mining the various mineral properties" (R. 1450).

[4] The figures are based on the low market price for that day's trading in Great American stock on the American Stock Exchange.

suant to the option agreement (R. 1231); and the closing took place on April 5 (R. 1372). At the closing, pursuant to a purchase contract which had been drafted by Pagnani and Irving H. Stolz, Great American's general counsel (R. 1382), the corporation received all of the outstanding stock of Basin and delivered 200,000 shares of Great American to Beard, as the sole shareholder of Basin (R. 1372).

The officers and directors who acted for Great American throughout the transaction were not told of the agreement between Matusow, Pagnani and Beard to divide the shares received (Pet. App. B12, B80, B85). At the closing, Bernard D. Marren, the financial vice president of Great American, referred to the provision of the purchase contract which recited that the stock of Basin was owned by Beard "and others, less than ten (10) in number, who have beneficial interests therein" (R. 1453). Marren "asked specifically who were the other individuals with a beneficial interest in Basin Mining Company," and Beard's answer was that "they were local associates of his." Marren noted "that paragraph 11 of the purchase contract stated that 'the parties agree that no broker or finder has brought about the transaction contemplated by this agreement'" (R. 1372–1373). Matusow asserted in his affidavit before the district court that when Marren "asked who the 'others' were," Matusow "told him that the others were PAGNANI and me." He said nothing more (R. 1445). Pagnani, who had participated in the drafting of the contract which stated that no finders were involved (R.

1460), does not claim to have said anything regarding this matter at the closing. He sat silent (R. 1407-1408).

2. THE DECISION OF THE DISTRICT COURT AS TO PETITIONERS

The district court found that although the persons representing Great American "knew that Matusow and Pagnani were to be compensated by Beard" and "knew Matusow as a finder who was connected with Beard * * * and * * * Pagnani as Beard's attorney," there was no evidence that they knew about the agreement by Matusow, Pagnani and Beard to allocate the Great American shares at a five-sixths to one-sixth ratio with Matusow receiving four-sixths for his services as a finder (Pet. App. B80, B85). The court held that the failure of petitioners to disclose this allocation of the shares was not a violation of Section 10(b) and Rule 10b-5, since, in its view, the allocation was not a material fact. In order to establish materiality, the court reasoned, the Commission was required to prove either that the property was not actually worth the number of shares issued for it by Great American,[5] or that "had GAI known that the stock it issued to the nominal seller was not going to be retained by him but was going to be distributed among several other people it would not have issued it, irrespective of the value of the property" (Pet. App. B85).

---

[5] The court held that since the Commission did not allege that the property was not worth the value of the shares, it had to be assumed that the property was worth that value (Pet. App. B84).

3. THE DECISION OF THE COURT OF APPEALS AS TO PETITIONERS

The court of appeals rested its holding that petitioners violated Section 10(b) and Rule 10b-5 on the narrow ground that the failure of Matusow and Pagnani to "speak up" and disclose the full truth in answer to the question asked by Marren constituted common law fraud in connection with their purchase of securities from Great American, and thus violated Rule 10b–5 (Pet. App. B17). Citing the common law "principle that 'One party to a business transaction is under a duty to disclose to the other before the transaction is consummated . . . such additional matters known to him as he knows to be necessary to prevent his partial statement of the facts from being misleading . . . ,'"[6] the court stated that "Marren's question required those present at the closing to speak up and clarify what was meant in the purchase agreement by 'finders' and 'local associates,' and to explain their financial relationship" (Pet. App. B18). The court's ruling that the allocation of four-sixths of the shares as a finder's fee was a material fact[7] was based on its conclusion, stated with regard to finders fees paid in the Nevada transaction, that "willingness to pay intermediaries two-thirds of the price * * * is so unusual as to raise legitimate question * * * whether

[6] Restatement, *Torts* 24.551(2)(b) (Tent. Draft No. 12, April 27, 1966).

[7] The court did not, as Pagnani's argument implies (Pag. Pet. 14), hold that the payment for legal services of one-sixth of a purchase price would be a material fact required to be disclosed.

GAI had not been 'taken' and whether the * * * mine was worth anyhing like what GAI was paying for it" (Pet. App. B15). Because the district court had applied an incorrect test of materiality, the judgment was reversed and the case remanded for entry of an appropriate injunction.

ARGUMENT

Seven of the eight court of appeals judges sitting *en banc* agreed that the allocation of four-sixths of the Great American shares as a finder's fee was a material fact, and that the failure to disclose that fact in answer to Marren's question at the closing violated Rule 10b–5.

Petitioners do not claim that the court of appeals applied an improper standard of materiality[8] but question only its application to the facts of this case. That application was proper and, in any event, this narrow issue does not warrant review by this Court. Nor does the court's proper application to particular statements made by parties to a business transaction

[8] The court applied the standard of materiality established both at common law and in prior 10b–5 cases: whether "'a reasonable man would attach importance . . . [to the information] in determining his choice of action in the transaction in question'" (Pet. App. B14). See 1 Harper and James, *Torts* 565–566 (1956); Prosser, *Torts* 554–555 (2d ed. 1955); Restatement, *Torts* § 538(2)(a) (1938); *Myzel* v. *Fields*, 386 F. 2d 718, 734 and n. 7 (C.A. 8), certiorari denied, 390 U.S. 951; *Rogen* v. *Ilikon Corp.*, 361 F. 2d 260, 266 (C.A. 1); *Securities and Exchange Commission* v. *Texas Gulf Sulphur Co.*, 401 F. 2d 833, 849 (C.A. 2) (*en banc*), certiorari denied *sub nom. Kline* v. *Securities and Exchange Commission*, No. 937, this Term, *Coates* v. *Securities and Exchange Commission*, No. 897, this Term, April 21, 1969.

of an accepted principle of the common law of fraud as a basis for finding a violation of Rule 10b–5 warrant further review.

1. Petitioners argue that the existence of an extraordinarily high finder's fee could not be found to be a material fact unless the Commission proved that the Arizona property was in fact not worth the purchase price of 200,000 shares. Relying, as did the district court, upon the Commission's statement that it was not alleging that the mining property was without any value,[9] they erroneously assert that it must be presumed that the property was in fact worth what Great American paid for it and, therefore, that the finder's fee was not material (Pag. Pet. 10–11; Mat. Pet. 9).

The court of appeals correctly rejected the district court's presumption[10]; if any presumption were warranted, it would be that the payment of two-thirds of the selling price as a finder's fee indicated that the property was grossly overpriced. At the time of the sale no definite value had been established for the property. For an enginering report, concerning the

[9] The Commission had pointed out that the value or potential of this largely unexplored mining property could not be definitely known either by the Commission or by the petitioners (Pet. App. B69).

[10] If this presumption were in effect as to mining properties, the value of which cannot be determined without extensive exploration, the Commission could never charge that a misstatement or omission regarding such a property was material unless the Commission itself had conducted sufficiently extensive exploration of the property to be able to prove that the asserted value of the property was in fact erroneous. Obviously, this would curtail, if not end, the Commission's enforcement activities with regard to the securities of mining companies.

possible existence of an ore body on the property, which was prepared for Great American largely on the basis of physical testing which had been conducted by Beard, the owner of the property, who was prepared to give up five-sixths of the proceeds of sale to someone who could find a buyer, specifically recommended to Great American that it conduct further exploration of the property before exercising its option (R. 1288).[11]

Once the district court's presumption of value was rejected, it became obvious that knowledge of the extraordinary finder's fee[12] being paid by the seller of the Arizona property might well affect a reasonable man in determining whether or not to purchase the property or how much to pay for it (Pet. App. B14–B15). Moreover, in the circumstances of this case, in which Marren inquired about the identity of other interested persons and the existence of finders in the transaction, petitioners were put on actual notice that the existence of a finder's fee might influence the purchaser.[13]

[11] The reliance on Beard's testing by those who prepared the report was apparent from the conclusion of the report: "If the * * * results [of additional exploration] are promising, proceed with the acquisition of the property. If the results are negative, you have gambled and lost $72,000" (the estimated cost of the exploration) (R. 1288).

[12] Contrary to Matusow's present assertion (Mat. Pet. 12) that he was Beard's "partner" and therefore could not be classified as finder, both the court below and the district court recognized Matusow as a finder (Pet. App. B17, B80, B85), in accordance with the plain terms of the "joint venture" agreement (R. 1449).

[13] These distinguishing circumstances are ignored in petitioners' reliance (Pag. Pet. 10–11; Mat. Pet 9) on the court of ap-

2. The court of appeals correctly held that petitioners' conduct amounted to common law fraud violative of Rule 10b–5. Contrary to what petitioners seem to indicate (Pag. Pet. 12, Mat. Pet. 10), the court relied not only on the circumstance that Marren asked who had an interest besides Beard, but also on Marren's express indication of concern over whether there were any finders involved in the transaction (Pet. App. B17).

Petitioners argue that, by disclosing to Marren that they were the "other persons" beneficially interested in Basin, they put Great American on notice as to their interest. But Marren, upon hearing the limited answer given by Matusow and acquiesced in by Pagnani, and upon reading the clause of the contract, prepared by Pagnani, which stated that there were no finders, would reasonably conclude that no finders fees were being paid. Even assuming, *arguendo,* that Marren might have guessed that Matusow was a finder, he would reasonably assume that only an ordinary finder's fee was being paid.

Contrary to petitioners' contention, *First Trust & Savings Bank* v. *Fidelity-Philadelphia Trust Co.,* 214 F. 2d 320 (C.A. 3) (Pet. App. C1), is not in conflict with the decision below as to any principle of common law fraud.[14] The two courts of appeals merely reached

---

peals' stated reluctance to order entry of an injunction against the corporate officials solely on the basis of their nondisclosure in a press release of finders fees paid by the sellers in another transaction.

[14] The court stated in *First Trust and Savings Bank* (Pet. App. C9–10, footnote omitted):

"We do not go with the argument that when a man says

different results in applying the same legal principles to different factual situations. In *First Trust,* the court determined that the statement made by the defendant gave sufficient warning to the other party to a transaction. In the instant case, the court held (Pet. App. B17) that petitioners' statement "was so far from the full truth" that it served to mislead, rather than to warn.

Pagnani also argues (Pag. Pet. 14–16) that because he was present at the closing as counsel to Matusow and Beard, he was entitled to remain silent. This belated claim of attorney-client privilege cannot, however, serve to disassociate Pagnani from the "joint venture" agreement [15] between himself, Matusow and Beard (an agreement, signed by him, which makes no mention of legal services, and under which he promises to provide services as a finder), even though he also did legal work for the joint venture group. Indeed, Matusow pointed out in his affidavit before the district court that "there is a continuing business relationship between *Beard, Pagnani,* and me in the form of various corporate enterprises, one of which is Beard Engineering Inc. * * *" (R. 1445). When a lawyer wears two hats, he cannot rely on the attorney-client privilege to excuse his own wrongdoing in his non-professional capacity. There is no

---

something that is literally true he has told the truth even though he does not tell the other things which would qualify the statement made. 'To tell half a truth only is to conceal the other half.' * * *"

[15] As a result of the agreement, Pagnani actually owned one-sixth of the stock of Basin Mining Co. prior to the exercise by Great American of its option (R. 1449).

such special immunity for attorneys who participate as a principal in transactions which violate the federal securities laws—or any other legal standard of conduct.[16]

3. Relying on the Fifth Amendment, petitioners also complain that Rule 10b–5 is not sufficiently definite to have given them notice that their conduct was proscribed (Pag. Pet. 16–18; Mat. Pet 13–14).

In this area "[t]he test is whether the language conveys sufficiently definite warning as to the proscribed conduct when measured by common understanding and practices." *Jordan* v. *De George,* 341 U.S. 223, 231–232; accord, *United States* v. *National Dairy Products Corp.,* 372 U.S. 29, 32; *McGowan* v. *Maryland,* 366 U.S. 420, 428; *Sproles* v. *Binford,* 286 U.S. 374, 393. See, also, *Securities and Exchange Commission* v. *Capital Gains Bureau,* 375 U.S. 180, 193, n. 41, 199.

There are, of course, some areas of the law in which it is not possible to anticipate all forms of harmful conduct by specific rules. Prohibitions of fraud and deception fall within this category. Rule 10b–5 is necessarily stated in rather broad terms, which absorb their meaning from the particular business context in which the deceptive practices occur. Cf. *Securities and Exhange Commission* v. *Chenery Corp.,* 332 U.S. 194, 202–203.[17] It is apparent on the face of the statute

[16] Cf. *United States* v. *Benjamin,* 328 F. 2d 854, 863 (C.A. 2), certiorari denied *sub nom. Howard* v. *United States,* 377 U.S. 953.

[17] See, also, remarks of Judge Friendly in *Conference on Codification of the Federal Securities Laws,* 22 Bus. Lawyer 793, 900, 901 (1967).

and rule that misleading statements and half truths, such as occurred here, are proscribed.

4. The court of appeals acted well within its discretion in ordering the entry of an "appropriate" injunction, on the basis of the district court's findings and their legal significance.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted.

ERWIN N. GRISWOLD,
Solicitor General.

PHILIP A. LOOMIS, JR.,
General Counsel,

WALTER P. NORTH,
Associate General Counsel,

MEYER EISENBERG,
Associate General Counsel,

THEODORE S. KAPLAN,
Attorney,
Securities and Exchange Commission.

MAY 1969.

U.S. GOVERNMENT PRINTING OFFICE: 1969